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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED

NOV 30 1998

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IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF ITS STRANDED COST RECOVERY.	DOCKET NO. E-01345A-98-0473
IN THE MATTER OF THE FILING OF ARIZONA PUBLIC SERVICE COMPANY OF UNBUNDLED TARIFFS PURSUANT TO A.A.C. R14-2-1601 et seq.	DOCKET NO. E-01345A-97-0773
IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY	DOCKET NO. E-01933A-98-0471
IN THE MATTER OF THE FILING OF TUCSON ELECTRIC POWER COMPANY OF UNBUNDLED TARIFFS PURSUANT TO A.A.C. R14-2-1601 et seq.	DOCKET NO. E-01933A-97-0772
IN THE MATTER OF COMPETITION IN THE PROVISIONS OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. RE-00000C-94-165 **COMMENTS OF CALPINE POWER SERVICES**

Calpine Power Services hereby files the following comments on the settlement agreements between Commission Staff and Tucson Electric Power Company ("TEP") and Arizona Public Service Company ("APS"), and the Memorandum of Understanding Between APS and TEP.

Timing of Electric Competition and Consideration of the APS/TEP Settlement Agreement Are Not Interdependent.

The Electric Competition Rules provide for the commencement of partial electric competition effective January 1, 1999. The time in which to approve, reject or modify the APS/TEP Settlement

Agreement does not relate to the commencement of electric competition.

TEP asserts that electric competition should not begin until all stranded cost issues have been resolved. TEP claims that no competitive certificate of convenience and necessity may be granted until all stranded cost issues have been resolved. This is a red-herring argument. All stranded cost issues will not be resolved by the approval of the APS/TEP agreement. Recovery of stranded costs is an ongoing process, including an interim mechanism for recovery of those costs. The Electric Competition Rules provide for the collection and recovery of legitimate and unmitigated stranded costs.

Staff asserts that the agreement must be approved before January 1, 1999 otherwise there will be "economic disruptions in Arizona" if the Salt River Project opens its market first.[1] The Commission's Electric Competition Rules already provide for open competition on January 1, 1999. It is in the interest of APS and TEP to move forward under the Electric Competition Rules and withdraw their litigation so that they may compete in the Salt River Project service area and provide those same benefits within their distribution service areas. January 1, 1999 should be viewed as an incentive for APS and TEP to comply with the Electric Competition Rules, and not a means to extract concessions from the Commission Staff or the Commission.

The Agreement Adopts the "Net Lost Revenues" Approach Which Overstates Stranded Costs and Which Was Rejected Previously by the Commission.

An about-face is being proposed in the agreements, as to the methodology for recovering stranded costs. Previously, the Commission rejected the "net lost revenues" approach for the recovery of stranded costs. After extensive testimony during the stranded cost hearings, many experts concluded that the "net lost revenues" approach overstates the amount of stranded cost that the utilities will collect.[2] The stranded cost approach in these agreements does not relate strandable

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[1] Direct Testimony of Ray T. Williamson (Nov. 20, 1998) at 7.

[2] *See* Initial Brief on Behalf of Electric Competition Coalition, Enron Corporation, and Enron Energy Services, Inc. (ACC Docket No. U-0000-94-165) (Mar. 16, 1998) at 14-17.

costs to the advent of competition or uneconomic generation. The same revenues with or without competition will flow to the utility with any shortage denominated as stranded cost.[3] The apparent trade-off is the granting of the APS and TEP methodology for stranded costs in exchange for settlement of lawsuits. However, opponents to the Electric Competition Rules have been unsuccessful in their litigation to date. The market-based determination of generation has proven to be the most accurate basis for setting stranded costs and the Commission is urged to continue that methodology through the divestiture approach.

TEP's Transfer of Generation to APS Should Be Based Upon "Market Value."

TEP proposes to auction off certain generation assets, with a portion of those assets being "traded" to APS in exchange for some of APS's transmission assets. Neither the Agreement or the filed testimony of APS, TEP or Staff addresses the appraised "market value" of those assets or why the imputed price of the generation assets "traded" to APS is not based upon the comparable value of the generation assets that may be auctioned off. For example, the negotiated value placed on the generation assets to be acquired by APS could later be adjusted to reflect the market prices obtained through the auction, with appropriate adjustments for that type of generation, fuel contracts and so forth. Mr. John G. Paton testified on behalf of TEP that approximately 15 utilities have sold mostly gas-fired generation assets for prices of less than one to over 5 times their book values.[4] The Memorandum of Understanding Between APS and TEP uses book value for the transmission assets and alleged "fair market" value for the generation assets. No testimony has been provided as to the determination of this alleged market value or how it relates to the book value of TEP's generation assets.

The 345 kV Voltage Level for Determining APS's Distribution Facilities Should Be Rejected.

"The most important obstacle to achieving a more competitive electric power industry centers

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[3] *Id.* at 20-23.

[4] Direct Testimony of John G. Paton (Nov. 20, 1998) at 10.

on conditions of access to the transmission systems through which power is moved from generation plants to consumers," according to economist Douglas Houston of the University of Kansas.[5] Houston went on to note that "utility-controlled transmission forms a seemingly impenetrable barrier to competition and therefore either the control or the direct ownership of transmission must be fully wrenched from the utilities. Otherwise, the utilities will rig access conditions so that newcomers always are at a disadvantage."[6]

Transmission facilities of 69 kV and above, plus all facilities between 30 kV and 69 kV that serve a transmission function, should be available to all consumers and newcomers, under the transmission tariff. These levels, for example, were used by the Wisconsin Public Service Commission when it adopted principles of open access of its statewide transmission system.

APS proposes to place all facilities below the voltage level of 345 kV under the jurisdiction of the Commission, and APS asserts, in the agreement, that such voltage level and below is a distribution function.[7] In the past, consumers usually viewed voltage levels between 345 kV and 69 kV as transmission service. Consumers and competitors should be assured that no additional charges will be collected by APS, other than a FERC Order 888 rate for transmission service, will be assessed for the use of these lines. If APS imposes another layer of "transmission distribution" tariffs on consumers and competitors, it will in essence be "pancaking" an additional or increased access charge on new entrants and increasing the cost of competitive power to consumers. Competitors would pay either the region-wide "postage stamp" or "license plate" rate for regional transmission, <u>plus</u> the APS "transmission distribution" rate in order to deliver power to consumers in the APS service area. This would be an unreasonable trade barrier to new entrants. The Commission should examine any

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[5] Douglas A. Houston, "Toward Resolving the Access Issue, User-Ownership of Electric Transmission Grids," August 1991, p. 1 (This study was performed for the Reason Foundation of Santa Monica, Calif.).

[6] *Id.*

[7] APS Settlement Agreement (Nov. 4, 1998) at 4.

anticompetitive effects associated with the assertion by APS that voltage levels between 69 kV and 345 kV (and facilities between 30 and 69 kV that serve a transmission function) be treated as part of its distribution system.

In Order 888, FERC listed seven local distribution indicators for the states to use in evaluating the delineation between transmission and distribution:

1. Local distribution facilities are normally in close proximity to retail customers.
2. Local distribution facilities are primarily radial in character.
3. Power flows into local distribution systems; it rarely, if ever, flows out.
4. When power enters a local distribution system, it is not reconsigned or transported on to some other market.
5. Power entering a local distribution system is consumed in a comparatively restricted geographical area.
6. Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.
7. Local distribution systems will be reduced voltage.

FERC Order 888, *Fed. Reg.* Vol. 61, No. 92, P211541.[8] FERC Order 888-A reaffirmed this test for distinguishing between transmission and distribution facilities. *Fed. Reg.* Vol. 62, No. 50, P12,372.

No evidence has been presented by APS or any other proponent of these settlement agreements which illustrates that transmission facilities of less than 345 kV should be deemed to be within the APS distribution system. Mr. Jack Davis of APS argues that "transmission lines less than 345 kV are required to move power around and within the APS distribution system and represent that part of the transmission system which APS is obligated by contract to coordinate with SRP."[9] Recognition of this high level of voltage as being in APS' distribution system will stunt "retail

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[8] *See* Legal Issues Working Group, *Report to the Arizona Corporation Commission* (Sept. 30, 1997) at 42-44.

[9] Testimony of Jack E. Davis (Nov. 20, 1998) at 8.

wheeling" which otherwise would allow for end users to purchase electricity from any generator and have that power wheeled to their retail facilities. Furthermore, this expansive definition of distribution facilities will enlarge the local monopoly of APS' distribution system to the disadvantage of newcomers.[10]

The Proposed Transco Should Not Preclude Others from Building or Owning Transmission Facilities.

The agreement provides for the creation of a transco. "A key feature of the transaction is that transmission rates will not be increased for customers in the current service territories of TEP and APS," according to the testimony of Mr. James S. Pignatelli of TEP.[11] Transmission rates are set by the Federal Energy Regulatory Commission (FERC). However, the agreement does not provide adequate assurances that these transmission rates will not be increased, or should perhaps be decreased, or additional transmission facilities will be constructed for new entrants.

TEP's proposed transco intends "to become the builder and owner of transmission assets in Arizona."[12] Making competitive generation available to the Arizona market is tied to the availability of transmission. In some cases, it may be more cost-efficient for a new entrant or third party, such as the Western Area Power Administration, to build, own and operate a certain portion of the transmission system. The Agreement should provide for such flexibility and assurances, in order that new entrants and Arizona consumers may receive the maximum economic benefit.

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[10] The primary factors determining line capacity are voltage and length. Capacity increases roughly as the square of the voltage. For example, the capacity of a 50-mile, 230 kV line is 390 megawatts. Larry Weiss and Scott Spiewak, *The Wheeling and Transmission Manual* (1991) at 54, and National Regulatory Research Institute, *Some Economic Principles for Pricing Wheeled Power* (1987) at 52.

[11] Direct Testimony of James S. Pignatelli (Nov. 20, 1998) at 4.

[12] Direct Testimony of John G. Paton (Nov. 20, 1998) at 5.

The agreement assumes that an Independent System Operator (ISO) will be established to operate the transmission system in Arizona.[13] However, the agreement does not address what will happen if an ISO is not created by December 31, 2000.

The Commission Should Retain Its Oversight of the Competitive Market Environment.

One benefit of the agreement, according to Mr. Pignatelli, is that "the Agreement allows the Commission to retain complete oversight over the entire transaction, as well as over TEP on a going-forward basis."[14] The Commission should receive further assurances that an open and competitive market environment will occur. The Commission should retain its constitutional authority to assure the public that a competitive electric market will mature in Arizona. Furthermore, the agreement should contain a clause that will make the agreements null and void if there are insufficient incentives for new entrants to compete in the Arizona market.

Future Mergers, Acquisitions and Restructuring Are Not Addressed in the Agreements.

The agreements are silent as to what may happen if APS or TEP is involved in a merger, acquisition or restructuring of its company, its utility distribution company or the transco. Major changes in this framework could have an adverse effect on the competitive electric environment in Arizona. The Commission should retain the right to reopen these agreements if a merger, acquisition or restructure of APS or TEP should occur in the future.

DATED this 30th day of November, 1998.

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[13] *See* Direct Testimony of James S. Pignatelli (Nov. 20, 1998) at 4 and Direct Testimony of Ray T. Williamson (Nov. 20, 1998) at 4.

[14] Direct Testimony of James S. Pignatelli (Nov. 20, 1998) at 5.

ORIGINAL and ten copies of the foregoing were filed this 30th day of November, 1998 with:

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COPIES of the foregoing were *hand-delivered* this 30th day of November, 1998 to:

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COPY of the foregoing was *faxed* this 30th day of November, 1998 to:

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COPIES of the foregoing were *hand-delivered* or *mailed* this 30th day of November, 1998 to:

All parties of record in the above-referenced Docket

By Venus Green